European Commission: German Tax System Discriminates Against Non-Residents, Particularly Artists, Sportsmen and Journalists

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The European Commission has concluded that German tax regulations for non-resident taxpayers introduced in April 2007 are incompatible with the freedom to provide services. The Commission announced its decision in a press release on 31 January 2008. In a Supplementary Reasoned Opinion under Article 226 of the EC Treaty, it therefore requested Germany to modify the system.

In contrast to resident taxpayers who have to declare their income annually, certain categories of non-residents (mainly artists, sportsmen and journalists) have to pay a withholding tax at source of a maximum of 25% on their gross income. Business expenses cannot be deducted from their gross income, but are only taken into account in a subsequent refund procedure. Only business expenses directly linked to activities carried out in Germany may be refunded.

In March 2007, the Commission had concluded in a Reasoned Opinion under Article 226 of the EC Treaty that the combination of these two provisions led, in many cases, to higher taxation than that applicable to residents and had asked Germany to modify the system within two months. Following a ruling by the European Court of Justice in case C-290/04 (Scorpio), the German Federal Ministry of Finance had published a circular on 5 April 2007, allowing business expenses to be deducted in the withholding tax procedure. However, this only applied if the business expenses exceeded 50% of income because, according to the Ministry, a business expenses rate of 50% was already included in the rate of taxation. Where business expenses were allowed for deduction, the withholding tax rate was therefore increased from 25% to 40%. In the Commission's view, these restrictions imply that the system still discriminates against non-resident taxpayers.

The Commission's opinion is supported not only by the aforementioned judgment of the European Court of Justice, but also by two further judgments: in case C-234/01 (Gerritse) the ECJ had decided that the taxation of the gross income of non-residents (without the deduction of business expenses) violated Articles 49 and 50 of the EC Treaty if residents only had to pay tax on their net income after deducting business expenses, unless non-residents were subject to a uniform tax rate of 25% that was no higher than the progressive tax rate applicable to residents increased by the amount corresponding to the tax-free allowance.

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However, the Commission decided that this was often the case under the current regulations. In case C-345/04 (Centro Equestre), the ECJ had decided that Article 49 of the EC Treaty was breached by the rule that made the repayment of corporation tax subject to the condition that the applicable deduction of business expenses exceeded 50% of income.

European Commission press release of 31 January 2008

http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/144&format=HTML&aged=0&language=EN&guiLanguage=en

Rundschreiben des Bundesministerium der Finanzen vom 5. April 2007

http://www.bundesfinanzministerium.de/cln_01/nn_3416/sid_2F031436255525C1F2FFB09F33B21B8C/nsc_true/DE/Aktuelles/BMF__Schreiben/Veroffentlichungen__zu__Steuerarten/einkommensteuer/188,templateId=raw,property=publicationFile.pdf

Circular of the Federal Ministry of Finance of 5 April 2007

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